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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Periodic Reporting
(Proposal Five)

Docket No. RM2022-11

COMMENTS OF THE PUBLIC REPRESENTATIVE

(September 20, 2022)

I. INTRODUCTION

The Public Representative hereby provides comments pursuant to Commission Order No. 6242.[1] In that Order, the Commission established the above-referenced docket to receive comments from interested persons addressing the Posta Service's proposal to change analytical principles related to periodic reporting. *Id*. at 4 n. 5. The Postal Service filed the Petition, in accordance with 39 C.F.R. § 3050.11, along with a report of the research initiated to support Proposal Five.[2] The Postal Service provided supplementary information in its response to a Chairman's Information Request (CHIR),[3] and in public and nonpublic library references.[4]

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[1] Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Five), August 2, 2022 (Order No. 6242).

[2] Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Five), July 29, 2022 (Petition, Proposal Five); "Report on Contract Delivery Service Cost Attribution Accrued Cost and Distribution Key" (CDS Report).

[3] Responses of the United States Postal Service to Questions 1-7 of Chairman's Information Request No. 1, September 13, 2022 (Response to CHIR No. 1).

[4] Docket No. RM2022-11, Library Refence USPS-RM2022-11/1 - Public Material Supporting Proposal Five, July 29, 2022; Docket No. RM2022-11, Library Refence USPS-RM2022-11/NP1 - Nonpublic Material Supporting Proposal Five, July 29, 2022.

II. BACKGROUND

The Postal Service instituted a research into the estimation of accrued costs and product costs of Contract Delivery Services (CDS) following the USPS Office of Inspector General (OIG) Audit Report Number 20-313-R21.[5] Petition, Proposal Five at 1. The OIG Audit report suggested a two-part tasks to the Postal Service: 1) reexamine the cost proportion percentages currently used to estimate accrued CDS costs, assess the potentiality of applying actual CDS payment data to calculate product costs, and propose to update the current costing methodology if considered appropriate; and 2) administrate a study to ascertain whether mail volumes delivered on CDS and rural routes are similar and, if so, propose to update the distribution keys currently used to attribute CDS costs. *Id*. at 1-2.

Under the currently accepted methodology for the treatment of CDS costs, the CDS accrued costs from the CDS suppliers, who are independent contractors providing delivery services on specific routes not serviced by city or rural carriers, are not separately identified in the Postal Service's general ledger (GL). *Id*. Rather, the CDS accrued costs are included as part of dissimilar GL expense accounts subsumed in cost segment 14 (purchased transportation), components 143 (Highway) and 145 (Domestic Water), and are predominantly reported in GL Account No. 53605 – Intra-CSD Regular (Intra-District) – and Account No. 53601 – Intra-P&DC Regular where they are in majority and are accorded distinct treatment. *Id*. at 2. The CDS costs that are accrued in other accounts receive the same treatment that is applied to the non-CDS costs in the accounts. *Id*. The Postal Service clarifies that "[t]he treatment of CDS accrued costs in

[5] Office of Inspector General United States Postal Service, *Contract Delivery Service Cost Attribution*, Audit Report Number 20-313-R21, June 21, 2021, (OIG Audit). The OIG instituted the audit as part of its mandate under Postal Accountability and Enhancement Act of 2006 (PAEA) to regularly audit the Postal Service "data collection systems and procedures used to collect information and prepare reports." OIG Audit at 4 n. 16. The OIG's objective for the audit "was to assess whether all CDS costs are accurately captured and reliably attributed to mail products and services." OIG Audit at 4.

GL Account Nos 53605 and 53601 is distinct in that it instead follows the process described in the [CDS] Report at 1-3."[6]

The Postal Service calculates the CDS volume variability in a two-step process by developing a cost-to-capacity variability, which was updated in Docket No. RM2021-1,[7] developing a capacity-to-volume variability, which was updated in Docket No. RM2016-12,[8] and then multiplying the resultant variabilities to create the overall volume variability for the applicable contract costs. Petition, Proposal Five at 2-3. The calculation of volume variable CDS Intra-SCF costs is currently based on the two econometric analysis the Commission approved in the abovementioned dockets. *Id*.

The Intra-P&DC and Intra District account categories comprise four transportation technologies and route types in each category: box, city, van, and tractor trailer (TT). *Id*. at 3. The unit of analysis is the contract cost segments and they are portioned out to each grouping according to the route type, number of boxes, vehicle capacity, and route number. *Id*. The costs in each route/transportation type are summed to create the account category's cost proportions. *Id*. The cost-to-capacity volume variabilities for the Intra-P&DC and Intra-District accounts are separately estimated as the cost-weighted averages of the variabilities of the four transportation/route types,

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[6] Response to CHIR No. 1, question 1.

[7] Docket No. RM2021-1, Order on Analytical Principles Used in Periodic Reporting (Proposal Seven), October 6, 2021 (Order No. 5999). The variability of cost with respect to volume (overall volume variability) is developed by taking the product of two variabilities: the variability of cost with respect to capacity (cost-to-capacity variability) and the variability of capacity with respect to volume (capacity-to-volume variability). Cost-to-capacity variability is defined as "the elasticity of the cost of purchased transportation relative to a change in the cubic-foot-miles [(CFM)] of capacity purchased." Order No. 3973 at 4-5.

[8] Docket No. RM2016-12, Order on Analytical Principles Used in Periodic Reporting (Proposal Four), June 22, 2017 (Order No. 3973). Capacity-to-volume variability is defined as "the elasticity of the [CFM]…of capacity purchased relative to a change in the overall volume of mail using the transportation segment being analyzed." Order No. 3973 at 5.

using the fixed cost weighting proportions approved in Docket No. RM2014-6 (Proposal Six)[9] and Docket No. RM2021-1 (Proposal Seven). *Id*.

The established model specifications for the box route equations are presented below.[10] The model's functional form is translog, regressing the natural log of the mean-centered annual cost against the natural log of mean-centered number of curbside boxes, route length, cross term variables, and geographic dummy variables that are not mean-centered.

$$\boxed{\begin{aligned} lnCost_j = \ & \beta_0 + \sum_{i=1}^{n} \delta_i D_i + \beta_1 ln\left(\frac{Boxes_j}{\overline{Boxes}}\right) + \beta_2 ln\left(\frac{Boxes_j}{\overline{Boxes}}\right)^2 + \beta_3 ln\left(\frac{RL_j}{\overline{RL}}\right) + \beta_4 ln\left(\frac{RL_j}{\overline{RL}}\right)^2 \\ & + \beta_5 ln\left(\frac{Boxes_j}{\overline{Boxes}}\right) * ln\left(\frac{RL_j}{\overline{RL}}\right) + \nu_j \end{aligned}}$$

The Postal Service has relied on the Intra-SCF distribution factors that have been estimated by the Transportation Cost System (TRACS)[11] quarterly since its introduction to distribute the CDS costs in Intra-SCF accounts, using the Intra-SCF distribution factors as logical proxy considering that CDS routes are not sampled in TRACS. Petition, Proposal Five at 3.

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[9] Docket No. RM2014-6, Order No. 2180 - Order on Analytical Principles Used in Periodic Reporting (Proposals Three through Eight), (Order No. 2180), September 10, 2014. The Postal Service in Docket No. RM2014-6 estimated, and the Commission approved the cost-to-capacity variabilities for regular highway transportation accounts based on the Transportation Contract Support System (TCSS) data for the fourth quarter of FY 2013. Also, the Postal Service in Docket No. RM2016-12 estimated the capacity-to-volume variabilities using data for regular transportation accounts, and the Commission approved them for regular accounts only. Order No. 5999 at 4-5.

[10] CDS Report at 3. In the equation, *Boxes* stands for the number of curbside boxes, *RL* stands for route length, *j* indexes individual contract cost segments, the "bar" notation indicates a mean value, D_i are categorical variables representing Postal areas, ν is a stochastic error term, and the β and δ coefficients are parameters to be estimated. *Id*.

[11] The introduction of TRACS was discussed in the Opinion and Recommended Decision, Docket No. R90-1, January 4, 1991, Vol. I at III-154–164; The TRACS Surface (Highway) subsystem is a continuous, ongoing statistical sampling system. On a quarterly basis, it produces an independent distribution key for each of five transportation modes representing four purchased highway contract groups: Inter-NDC, Intra-NDC, Inter-SCF, Intra-SCF, and VSD (vehicle service drivers). *See*, Docket No. ACR2021, Library Reference USPS-FY21-36, PDF file "USPS_FY21_36_TRACS.pdf" at 3.

III. SUMMARY OF PROPOSAL FIVE

In Proposal Five, the Postal Service relies on the outcomes of its investigation into the two recommendations made in the OIG Audit report to propose two modifications to analytical principles related to the estimation of accrued costs and product costs of CDS. The two Postal Service proposed changes are: first, to update the GL Account No. 53605 and Account No. 53601 cost proportions on an annual basis using the Transportation Contract Support System (TCSS)[12] data, and second, to use the rural cost distribution key (CS 10, component 260) to attribute CDS costs to products. Petition, Proposal Five at 4 n. 6.

Regarding the first modification that relates to OIG Recommendation One in the OIG Audit report, the Postal Service states that it reevaluated the cost proportions for the Intra-P&DC and Intra-District account categories using updated TCSS and Accounts Payable Excellence System (APEX) datasets. *Id*. at 4. The recalculated cost proportions for the two account categories using the FY 2020 and FY 2021 TCSS data revealed numerous shifts in varying degrees in the cost proportions for the period between FY 2013 and FY 2021. *Id*. The Postal Service calculated Intra-P&DC and Intra-District cost proportions using the Docket No. RM2021-1 methodology, noting that the cost proportions for Intra-District account category have not been updated since Docket No. RM2014-6. *Id*. at 4-5.

The Postal Service asserts that it evaluated the viability of employing the CDS payment data from APEX to form the cost proportions for the Intra-P&DC and Intra-District account categories, and, thereafter, resolved that APEX data do not include information on vehicle capacity,[13] which is necessary to apportion payments between all

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[12] TCSS is a database that contains account and transportation activity data. Order No. 2180 at 12; Overall cost-to-volume variability is a product of two variabilities (cost-to-capacity variability estimated using TCSS data and capacity-to-volume variability estimated using TRACS data). Order No. 3973 at 31.

[13] The Postal Service defined vehicle capacity as CFM of transportation used. The cubic foot miles of vehicle capacity for each route are estimated as a product of vehicle capacity measured in cubic feet (cube) and annual route distance measured in miles (miles). Annual route miles are determined as the product of the average trip distance on the route and the average number of trips on the route. Given

four transportation/route types. Petition, Proposal Five at 5. The Postal states that in its inquiry about the feasibility of using the data to estimate accrued and volume variable costs, it was concluded that the APEX data did not meet the Commission's evaluation standard, which is to "improve the quality, accuracy, or completeness of the data or analysis of data." *Id*. at 5-6.

Upon consideration of the second modification that relates to OIG Recommendation Two in the OIG Audit report, the Postal Service avers that its review of available literature materials relating to CDS so as to explore the possibility of applying a more appropriate distribution keys to CDS costs ostensibly indicates that "both operational protocols and field observations support the hypothesis that similar mail volumes are delivered on CDS routes and rural routes." *Id*. at 6. The Postal Service claims that documented data confirmed the similarities in the activities that CDS contractors and rural carriers perform, and that existing process for the conversion of CDS routes to rural routes in comparable offices further attests to the similarities in activities between CDS suppliers and rural carriers. *Id*. at 6-7.

IV. COMMENTS

A. Reevaluation of the Cost Proportions for Estimating CDS Costs

The Public Representative agrees with the Postal Service on the necessity to update the GL Account No. 53605 and Account No. 53601 cost proportions on an annual basis using TCSS data. The annual update of the cost proportions will reflect and/or capture the changes that may occur to the account categories' cost proportions and variabilities over periods. In order to achieve more accuracy and dependability in the estimated CDS cost proportions, the Public Representative recommends that the

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that there is often more than one trip on each route, the number of annual route miles is calculated as a sum of all annual trip miles on this route. The annual trip miles for each trip are calculated as the product of a trip distance (measured in miles) and its annual operating frequency. Order No. 3973 at 34.

Postal Service should be directed to let all CDS costs accrue into only these two accounts in future if Proposal Five is approved. That will put an end to the current policy of accruing the CDS costs in unrelated accounts where they are treated similarly to the non-CDS costs in the hosts' accounts.

Although about 99 percent of the CDS costs currently accrue in the GL Account No. 53605 and Account No. 53601 as reported in the FY 2021 TCSS dataset, the Postal Service has not stated that there will never be a substantial change in the proportion of CDS costs accruing into the two accounts.[14] However, it has confirmed that "[c]hanges in either the individual variabilities for the transportation/route types or their relative proportions of the account category's costs can change the overall account category variability."[15] The Public Representative submits that a consistent accrual of the CDS costs into the two accounts will further improve the accuracy, inerrancy, and completeness of CDS cost reporting.

The Postal Service has reexamined the cost proportions for estimating the CDS costs by using the TCSS and APEX datasets. With the TCSS data, the methodology approved in Docket No. RM2021-1 was used to calculate the updated Intra-P&DC and Intra-District cost proportions.[16] The results show varying degrees of shifts in cost proportions in the period between FY 2013 and FY 2021, reinforcing the conviction that the cost proportions should be updated annually. The Postal Service notes that although the Intra-P&DC cost proportions was updated in Docket No. RM2021-1, the

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[14] The OIG reports that the Postal Service overestimated or underestimated its total accrued CDS costs for product costing in the past largely because it failed to isolate the costs in its GL accounts, resulting from capturing CDS costs with transportation-related expenses across 27 different GL expense accounts. OIG Audit at 1 n. 5-6. The Postal Service had "explained that they focused their accrued cost estimation on the two GL accounts [GL Account No. 53605 and Account No. 53601] because they contain the majority of CDS costs." OIG Audit at 6. The Public Representative notes and commends that the CDS costs now accrue into 7 GL expense accounts as reported in the FY 2021 TCSS dataset.

[15] Petition, Proposal Five at 3; *see also* CDS Report at 4.

[16] Petition, Proposal Five at 5; *see also* CDS Report at 6.

Intra-District account category has not received updated cost proportions since Docket No. RM2014-6.[17]

The Public Representative supports the assertion of the Postal Service that the APEX data do not contain information on vehicle capacity, which is necessary to allocate payments amongst the four transportation/route types. The Postal Service presents the declaration after evaluating the viability of using CDS payment data from APEX to form the cost proportions for the Intra-P&DC and Intra-District account categories.[18] This limitation impedes forming complete cost proportions for the transportation/route types in the Intra-P&DC and Intra-District account categories. The constraint forced the Postal Service to calculate cost proportions for box routes, transportation routes, and combination routes, using the APEX data.

B. Assessment of the Feasibility of Applying CDS Payment Data for Calculating Product Costs

The Postal Service compared the TCSS and APEX box/combination route costs to weigh the possibility of applying either source to estimate accrued and volume variable CDS costs. CDS Report at 7. The Postal Service reports discovering significant discrepancies between the costs in the two datasets for FY 2019, leading to its resolution that the APEX data did not measure up to the Commission's evaluation standard as enshrined in 39 C.F.R. § 3050.11(a). *Id*. Although the addition of combination routes in the FY 2021 data has reduced the differences considerably, the Public Representative confirms the Postal Service's claim that material differences persist between the two datasets when measuring CDS costs. The Public Representative fully agrees with the submission of the Postal Service that:

> APEX data cannot be used to fully isolate CDS costs from all box and combination route costs, because doing so requires vehicle capacity data. Therefore, an estimate of accrued and

[17] Petition, Proposal Five at 4; *see also* CDS Report at 4-5.

[18] Petition, Proposal Five at 5; *see also* CDS Report at 6.

> volume variable CDS costs using APEX data would also include costs associated with other transportation/route types.

CDS Report at 7-8.

The Public Representative performed analyses to compare the CDS accrued, volume variable, and institutional costs estimates derived from current TCSS cost proportions, the proposed TCSS cost proportions, and the proportions for the APEX data. The Public Representative corroborates the Postal Service's avowal that "[a]n annual update of the TCSS cost proportions will significantly reduce the discrepancy between the Postal Service's method for calculating accrued and volume variable CDS costs and the OIG's method for calculating these same costs."[19] Considering the current limitations of the APEX data, the Public Representative concurs with the Postal Service that it is better and more accurate to estimate volume variable CDS costs through the application of annually updated TCSS data-generated cost proportions.

C. Investigation of Appropriate Distribution Keys for Attributing CDS Costs

The Public Representative agrees with the Postal Service that the rural cost distribution key (CS 10, component 260) should be applied to attribute CDS costs to products. Currently, the Postal Service relies on the TRACS Intra-SCF distribution factors to distribute volume variable CDS costs to postal products. The Postal Service reports that its investigation into the appropriate distribution keys for attributing CDS costs showed that while strikingly similar activities are performed by CDS contractors and rural carriers, patently dissimilar activities are performed by the CDS suppliers and the Intra-SCF contractors.[20]

Additionally, the existing process for converting CDS routes to rural routes in comparable offices attests to the similarities between CDS contractors and rural

[19] Petition, Proposal Five at 8-9; *see also* CDS Report at 10

[20] Petition, Proposal Five at 6-7; *see also* CDS Report at 13.

carriers. *Id*. The Postal Service states that "[f]or comparable routes, cost comparisons can be conducted between CDS and rural routes based on a standardized form."[21] CDS routes deemed eligible for conversion and supported by data indicating financial or service benefits to the Postal Service may be converted from a CDS route to rural route, inferring that CDS routes and rural routes may have comparable volumes because CDS contractors perform some rural delivery activities prior to conversion.[22]

The Public Representative agrees that the rural distribution key would be a better proxy for distributing CDS costs than the currently applied TRACS Intra-SCF distribution factors, engendering an improvement in the precision and dependability of the product cost estimates for CDS. The glaringly inherent weaknesses in the Intra-SCF distribution factors, such as not attributing costs to DDU drop-shipped mail for CDS routes or accounting for ancillary/special services would be corrected by adopting the rural distribution key for the distribution of the CDS costs.

However, the Public Representative holds the view that the Postal Service should go beyond the limited analysis it performed to compare CDS and rural routes volumes and, in the not-too-distant future, perform an expanded analysis to compare the routes volumes so as to eliminate any "limitations in projecting interpretations to the entire Postal delivery."[23] The Postal Service asserts that "[t]he analysis provided in the

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[21] Petition, Proposal Five at 7; *see also* CDS Report at 14; Comparable routes are those routes where "[t]he CDS contract route must be in an office which only contains CDS and rural routes," and "[a] rural carrier must be capable of executing all activities of the CDS route." *Id*. The Postal Service states that these two factors encompass all the eligibility factors for conversion. Response to CHIR No. 1, question 4.

[22] Petition, Proposal Five at 7-8; *see also* CDS Report at 14-15; CDS routes converted to rural routes would prospectively be sampled in the Rural Carrier Cost System (RCCS) after conversion. *Id*.

[23] CDS Report at 16. The Postal Service reports that it replicated "the OIG analysis of the impact of WebEOR and PTR mail mixes on rural and CDS routes, observing that they are similar in this case." *Id*. at 15. It, however, notes that considering the "limited analysis only compared route volumes within the same offices and not in the system overall, there are limitations in projecting interpretations to the entire Postal delivery system." *Id*. at 15-16. It then maintains that whatever the limitations arising from the limited analysis, the "investigation does indicate that the application of the rural distribution key to CDS volume variable costs would improve the accuracy and reliability of the product cost estimates." *Id*. at 16.

OIG report provides a high-level comparison of the mail mix between CDS and rural routes servicing the same ZIP code on a sample of data."[24] Notwithstanding, the Public Representative abides with the opinion that considering that the CDS active contracts hovers around 8,000, with about $500 million in annual total costs,[25] an expanded analysis by the Postal Service to compare CDS and rural routes volumes will substantially give complete and incontrovertible credence to the submission that rural routes' distribution keys are more credible that the Intra-SCF factors for distributing CDS costs.

D. Impact of Updated Proportions and Distribution Key

The Postal Service reports that "[t]he implementation of both portions of the proposal using FY 2021 data results in a shift of $42.6M, or 1.2 percent, in highway costs from institutional to volume variable costs."[26] The Public Representative affirms that this shift from institutional costs, or unattributed costs, to volume variable costs is a positive shift because a portion of the ambiguous costs that are reported as part of institutional costs will now be attributed to specific competitive or market dominant products through the pursuance of the proposed revisions. It must be noted that for the Postal Service to break even, every institutional cost must be covered by market dominant products if it is not covered by the competitive products.

The Public Representative strongly believes that the higher the percentage of attributable costs, or volume variable costs, in the total accrued costs, the less

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[24] Response to CHIR No. 1, question 7. The Postal Service contends that (i) it neither tracks aggregated CDS volumes at the national level nor samples CDS routes in TRACS, (ii) the data employed for the OIG analysis are not granular enough to create a distribution key for direct comparison with the rural or Intra-SCF distribution keys, (iii) wholly devoid of the CDS distribution key, the purpose of the analysis "was to determine whether a more appropriate proxy could be utilized to distribute these costs," (iv) the analysis and similarity of operational activities indicate that rural delivery may be a better proxy for CDS than intra-SCF transportation," and (v) it did not consider it imperative to expand the OIG analysis because "the marginal benefit of expanding the analysis is assumed to be small." *Id*.

[25] OIG Audit at 1. The OIG reports that "[i]n fiscal year (FY) 2020, the Postal Service had more than 7,900 active CDS contracts, which cost a total of about $447 million." *Id*.

[26] Petition, Proposal Five at 11; *see also* CDS Report at 20.

contentious will be the argument in some quarters that market dominant products are currently contributing more than an appropriate share of the institutional costs to the advantage of competitive products.[27]

V. CONCLUSION

The Public Representative recommends that the Commission approves Proposal Five just as it simultaneously advices the Postal Service to implement the recommendations in the Comments section above.

The Public Representative respectfully submits the foregoing comments for the Commission's consideration.

Respectfully submitted,

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[27] The PAEA requires the Postal Service to ensure mail products and services cover their attributable costs, and it also requires that market dominant products do not subsidize competitive products and that each competitive product covers its attributable costs. 39 U.S.C. § 3633.